



Consulting Assistance for Economic Reform (CAER) II Paper
Directed by *Harvard Institute for International Development (HIID)*
Sponsored by USAID Contract PCE-Q-00-95-00016-00

DUMPING AND ANTI-DUMPING POLICY WITH APPLICATIONS IN LITHUANIA

JULY 1997

WILLIAM LOEHR

The views and interpretations in this paper are those of the author and should not be attributed to the Agency for International Development or the Harvard Institute for International Development.

IMCC, Corporate Offices
1201 Brickell Ave.
Suite 200
Miami, Florida 33131

IMCC, Washington Operations
2101 Wilson Boulevard
Suite 900
Arlington, Virginia 22201

TABLE OF CONTENTS

EXECUTIVE SUMMARY	i
Introduction:	1
Section 1: Review of concepts.....	1
Section 2: Determination of dumping under WTO rules and procedures	4
Section 3: Kinds of dumping and policy responses	8
Section 4: Summary	13
Section 5: Conclusions.....	13
Section 6: Recommendations	14

EXECUTIVE SUMMARY

This paper makes recommendations for Lithuania's policy on dumping and anti-dumping measures. It contrasts the economic definition of dumping with the definition adapted by the WTO. Economic dumping is defined as exporting an item at prices that are below cost, while the WTO defines dumping as exporting an item at prices below the "normal value" of the item in the exporting country.

Some of the observations that are made about dumping and WTO procedures are:

- Dumping as defined by the WTO takes no account of the impact of anti-dumping measures on consumers. Only the characteristics of producers are considered.
- Dumping as defined by the WTO is often unrelated to whether economic damage is implied for the importing country. Dumping is a legal issue for the WTO, not an economic issue.
- Most kinds of economic dumping do not imply economic injury for the importing economy. Only predatory dumping and dumping related to excess capacity are of great concern.
- Predatory dumping (defined in the text) is extremely rare. It should be dealt with by strengthening competition protection laws and their enforcement.
- Dumping related to excess capacity may injure producers in the importing country, but consumers may gain. If producers suffer from serious long-term injury the WTO escape clause would be a more appropriate and objective remedy than an anti-dumping measure.

The conclusion is that anti-dumping measures are not necessary, since economic damage from dumping is not likely. Where damage could occur, other measures are available. Furthermore, Lithuania's ability to administer an anti-dumping law and the anti-dumping measures that such a law would specify are both limited, and the process would be costly. Lithuania's abilities are limited at this time by:

- poorly performing customs administration;
- a large "hidden economy;" and
- limited resources for assessing "injury" and "normal value" in an exporting country; the need for structural adjustment that is not related to dumping but which brings pressures for protection. Lithuania will be under pressure from interest groups to provide anti-dumping duties even in cases where dumping is not occurring.

We recommend that Lithuania not pass anti-dumping legislation at this time. An anti-dumping law would likely be a waste of time and resources. Anti-dumping laws are optional under WTO, and one-half of WTO members do not have such laws, so Lithuania would not be extraordinary. Priority for the next few years should go to honoring the WTO commitments required of all members. Lithuania should strengthen already-existing laws that protect competitive markets. In addition to the other

favorable factors that such a law would bring, protection would be acquired against predatory dumping. Anti-dumping duties should not be used as a means of protecting inefficient industries. If industry restructuring is inhibited by adoption of WTO rules, WTO safeguards should be used for temporary protection while restructuring is done. Benefits to consumers should be considered whenever trade-related protective measures are contemplated.

Introduction

In Lithuania legislation is currently being designed to deal with dumping and to create anti-dumping measures. Dumping and anti-dumping measures have been defined and legalized by the WTO, though creating anti-dumping laws and imposing anti-dumping measures are optional for WTO members and are not required for WTO membership. About one-half of current WTO members do not have anti-dumping laws. Not having anti-dumping laws at the time of accession does not preclude passing anti-dumping laws at some future date. Since anti-dumping measures are not required, Lithuania must decide whether passing anti-dumping laws and implementing anti-dumping measures are justified, given the costs of maintaining them and the options available. Lithuania should have clearly in mind the costs to the country of allowing “dumping” as defined by the WTO, as opposed to the benefits and costs of creating anti-dumping measures.

Passing laws aimed at dumping and legalizing anti-dumping measures are not without risk. Anti-dumping measures, even if they are consistent with WTO, can be used to protect inefficient domestic producers instead of simply protecting the Lithuanian market from the effects of dumping. There are two main costs in maintaining anti-dumping measures: the cost of the bureaucracy needed to prosecute anti-dumping cases, and the cost of inefficiency that is perpetuated when anti-dumping measures are inappropriately applied. The benefits from anti-dumping measures are not always clear and are almost never very direct. Any anti-dumping law enacted in Lithuania should not be used to protect inefficient producers but should protect efficient markets and efficient producers. Unfortunately, application of WTO rules on dumping can allow either outcome and still be permitted within the WTO context. A productive discussion should deal with the following topics:

- Review of the economic concept of dumping;
- Review of the WTO concept of dumping--the WTO concept and definitions are not the same as economic concepts;
- Examination of the conditions that give rise to dumping as defined by the WTO, and review of the economic implications for Lithuania and other countries;
- Possible policy responses to cases where dumping is damaging to the local economy: What should policy try to do? What should policy try to avoid?
- Measurement of dumping and pursuit of an anti-dumping case within WTO rules and procedures.

Section 1: Review of concepts

The concept of dumping in international trade is not a new one (Viner, 1923). In the economics literature dumping is normally defined as selling a good at less than its marginal, or variable, cost. It is one of the standard maxims of microeconomics that

producers will maximize profits, or minimize losses, by producing at the point where marginal costs (variable costs) equal marginal revenue.¹ However, where marginal revenue is below variable cost, production should cease. In that way, losses are minimized. Comparisons of average cost and average revenue (price) have nothing to do with determining whether or not a producer continues to produce once a production facility is established. Pricing below average cost causes a producer to incur losses, but as long as some contribution is made to covering fixed costs after variable costs are covered, continuing to produce will tend to minimize losses.

Pricing below average cost is normal economic behavior whenever demand is depressed and a portion of costs is fixed. When demand is depressed, prices fall. Prices may fall such that the producer is not able to cover his total fixed cost and therefore incurs losses. Consider those producers who already exist and who face an unexpected dip in demand. They have already made their investments and have committed themselves to some fixed costs. The producer is faced with the choice of continuing to produce despite losses, or ceasing production. If he ceases production he will incur a loss equal to his fixed cost. If by maintaining production he can make some contribution to covering his fixed costs, he will do so. In this case, he will reduce his losses below what they would be if he ceased production. Therefore, when faced with the decision to continue or to cease production, the producer will choose to continue only if the price is sufficient to cover all variable costs and make some contribution to fixed costs, thereby minimizing losses. If the depressed price is simply a reflection of a market cycle, the producer may earn profits over the long run even though he incurs losses in the short run. If prices are depressed over the long run, perhaps because of excess capacity, some producers will eventually cease production as their capital stock wears out and their fixed costs drop toward zero. Clearly, for potential producers who have not yet invested, the activity in question is not attractive and they will not make new investments in it.

In economic analysis, selling items below the average cost of production is not necessarily dumping. Selling items below the variable cost of production may be dumping or illogical behavior. If it is the latter, those producers who are illogical will be quickly driven from business as losses mount. The simple observation that producers are selling below average cost is not sufficient economic information to determine if a firm is dumping. Only reference to variable costs can determine whether or not dumping may be occurring. If a firm is selling its product at a price below variable cost, then its motive for doing so is not profit maximization in the short run. Its motive may be a strategic one that aims at extraordinary profits in the long run. It may be dumping. Thus, any economic definition of dumping must be oriented around whether or not a firm is selling below costs. Furthermore, a strict definition would be selling at a price that is below average variable costs. For purposes of this paper, let us define economic dumping as selling an item below the variable cost of production.

¹Marginal revenue is the same as the price as long as the firm involved operates in competitive markets. In this discussion we will assume that this is the case.

The WTO definition of dumping is quite different. By WTO standards, dumping occurs when “products of one country are introduced into the commerce of another country at less than the normal value of the products” (GATT, 1969). The normal value is defined as:

- a. The comparable price, in the ordinary course of trade, for the like product when destined for consumption in the exporting country, or
- b. In the absence of such a domestic price...
 - i. The highest comparable price for the like product for export to any third country in the ordinary course of trade, or
 - ii. The cost of production of the product in the country of origin plus a reasonable addition for selling cost and profit.

Thus, an item may be determined to have been dumped if the export price is less than the normal price as defined here. We refer to this as WTO dumping.

The economic definition of dumping and the WTO definition are very different. The economic definition compares prices with variable costs. The WTO definition compares export prices with “normal value.” There are two main reasons for this difference. *First*, variable production costs are not easy to measure even where considerable information is available.² Furthermore, since accusations of dumping are aimed at firms, and production cost information is normally proprietary information, the information required to calculate variable costs is usually not available. The WTO required an operational definition of dumping that was measurable, and it therefore focused on variables that are relatively easy to measure and that are generally in the public domain. *Second*, the WTO definition reflects protectionist interests in the main contracting parties to GATT, primarily the U.S. and the EU. By the early 1970s, the various rounds of tariff negotiations under GATT had reduced normal tariffs to historically low levels, especially for industrial goods. However, this did not eliminate protectionist sentiment among enterprises that now had to compete in more open markets. Rather, new areas of protectionism appeared in non-tariff areas, and accusations of “dumping” was one of those areas. Particularly within the U.S.³ and the EU, protectionist forces were brought to bear to negotiate rules on dumping that

² This is particularly the case where a firm produces more than one product. The allocation of jointly incurred costs to individual production activities is particularly difficult.

³ The Kennedy round of tariff negotiations, ending in 1967, left the U.S. with extremely low tariffs, especially on industrial goods, and most NTBs had also been eliminated. It was not until 1974 that Congress renewed the President's authority to conduct new trade negotiations with the 1974 Trade Act. However, unlike in earlier acts, the president was empowered with much less negotiating authority. More power was retained by Congress and granted to the new International Trade Commission, both of which have been more cordial to protectionist sentiment than presidents have been. At the time (between about 1967 and 1975) concerns in the U.S. began to focus on the balance of payments problem, adjustment to the energy situation, competition with the newly industrializing countries of Asia and with an enlarged EC. Meanwhile, an expanding EC implied creation of common protective measures that were sufficient to induce new members into the club. The CAP remained a sticking point in GATT negotiations.

allowed considerable flexibility. Indeed, the WTO definitions and rules that resulted are ones that permit considerable protection even in cases where no economic damage is being done to the economy that is being “dumped upon.” Such rules can be used to maintain protection for inefficient producers who would not otherwise be able to compete in a world with few other barriers to trade. In the formation of WTO dumping definitions and rules, economic considerations have been largely forgotten.

Section 2: Determination of dumping under WTO rules and procedures

Imposition of anti-dumping measures against an exporting country involves two steps:

1. Dumping, as defined by WTO must be shown to have occurred. That is, the export price must be shown to be less than the “normal” price in the home market. A dumping “margin,” which is the extent by which the export price falls short of the normal price, must be determined.
2. Injury must be shown to have occurred or be threatened in the relevant activity in the country bringing the anti-dumping complaint.

If these conditions are met, then anti-dumping measures may be applied up to the amount of the dumping margin. In this section we will briefly examine some of the details involved in bringing an anti-dumping suit. This examination will show that the WTO criteria for meeting both of these points are biased in the direction of finding dumping, even where dumping is in doubt. Furthermore, a finding of WTO dumping does not imply that economic dumping has occurred. Indeed, WTO dumping can be found among firms practicing normal economic and business behavior.

2.1 Comparisons of normal value and export price

There are three ways that the **normal value** of an export item can be determined. The method preferred by the WTO defines the normal value as the price of the export item in the domestic market “in the normal course of trade.” Thus, where an export item is also domestically sold and consumed, there exists some domestic price to use as a reference point. However, many items are produced specifically for export and no domestic equivalent is available. Also, many export items are traded within firms, or among closely related firms, at prices that are not determined “in the normal course of trade.” Then, there are two alternatives. The first is the export value method, which uses as the normal value the highest comparable price for a like product exported to a third country.⁴ The second, used in the event that there are no comparable sales in third markets, is a constructed value method. The constructed value method estimates production costs and adds selling and administrative costs, as well as “normal profit,”

⁴ Note that the reference price is the highest price of a similar item exported to a third country. The similar item may be exported to many countries, but WTO rules allow the highest price to be used for comparison. Since we are ultimately interested in comparing the export price with this “normal value,” there is a bias in favor of finding a dumping margin.

to arrive at what is “normal.”⁵ This method uses many inputs which are arbitrary. Actual production cost information is unknown. Not only is this information normally proprietary, but also an anti-dumping proceeding is adversarial, and the exporting firm is not likely to reveal such information.⁶ Also, the margins that may be added (or subtracted) by the country bringing the suit are likely to be arbitrary relative to such margins actually experienced by the exporter.

To make them comparable with normal value, **export prices** must be adjusted so that both are compared at the same level in the sales process. Two problems arise in determining which is the export price that will be compared to the normal value in order to calculate the **dumping margin**.

First, there are often many export sales of the item in question to the country bringing the anti-dumping suit. Only one or a few sales would not normally even be noticeable and not attract anti-dumping attention. Which sales to use or how to aggregate a number of sales comes into question. In averaging export prices, the country bringing the suit may ignore sales that occur at below-normal value levels. The calculation may also ignore sales that occur at prices above the average price and may ignore extraordinarily low “sale” prices in the domestic market (Hidley, 1994). These allowances almost guarantee that dumping will be found.⁷ Grumwade’s example (1996:112) illustrates these biases well. Suppose the normal value of an item is determined to be 100. Suppose that there have been 20 export sales, 10 at 110 and 10 at 90. In calculating the export price, the ten sales at 110 may be ignored and only the ten at 90 used. Thus, dumping will be shown where none exists on average.

Second, many items are sold through sales companies, and the price of the export item in the country bringing the anti-dumping suit must be adjusted for sales-related costs so that comparisons can be made with the “normal value.” Indeed, deductions may be made for overheads, advertising costs of sales companies, and other costs that are applied asymmetrically. These costs may be deducted from export prices without also being deducted from “normal value” (Hidley, 1994). In constructing the **export price**, deductions for selling costs may include all costs, direct and indirect. When constructing “**normal value**,” only direct selling costs are deducted. Thus, the

⁵ Production costs in the country bringing an anti-dumping suit have nothing whatsoever to do with constructing the the normal value in the country against which the suit is being brought.

⁶Lithuania would surely have greater difficulty in acquiring information from foreign firms than larger countries do. When an anti-dumping suit is begun in the U.S. or in the EU, a standard questionnaire is sent to the foreign firm that is accused of dumping. The foreign firm has no legal obligation to respond, but is likely to do so because it does not want to risk losing the large U.S. or EU market. Responses sought by the U.S. or EU are very detailed and imply significant costs to the respondent. Small countries such as Lithuania do not hold out the promise of such a large market, and yet the costs to a foreign firm of complying with a Lithuanian request may not be significantly less than complying with a U.S. or EU request. The foreign firm is likely simply to ignore the Lithuanian request. This is a common response to requests by small, lower income countries. Firms would rather put up with an anti-dumping measure than bear the cost of complying with requests.

⁷ The implementation agreement on anti-dumping measures expresses a preference for weighted average to weighted average comparisons or transaction by transaction comparisons in determining “normal value.” However, if countries bringing an anti-dumping suit claim there is a reason why this cannot be done, then they can resort to the exclusions from the averaging process.

procedure for backing out selling costs reduces the export price by more than the normal value, thereby creating a bias toward finding a **dumping margin**. Again, to use Grumwade's example of EU practice (p.113), suppose we are examining an item produced in and exported by Japan to the EU. Suppose further that the item is produced in Japan for 100 and sold in both Japan and the EU for 150. Calculation of the export price would involve subtracting direct (20) and indirect (20) selling costs and a normal profit (10) for an export price of 100. The "normal price" would be calculated by subtracting only direct selling costs (20) and normal profit (10).⁸ "Normal price" would be found to be 120, and again, dumping would be found where none exists.

Biases toward finding dumping where dumping may not exist can be found elsewhere in WTO rules and procedures. Furthermore, where dumping is found, the procedures described widen the dumping margin. The dumping margin is important because anti-dumping duties are limited to the dumping margin. Thus, the procedures allowed can find dumping where it doesn't exist and exaggerate the size of protection that is available.

Lithuania is not likely to be able to construct a convincing case that dumping has occurred without the expenditure of considerable effort. There are several reasons for this. *First*, it is not likely that most foreign firms would voluntarily provide the information necessary to build the case that dumping has occurred. Many companies would find the costs of cooperation too high and would prefer to risk an anti-dumping duty. *Second*, in the absence of information volunteered by the accused companies, Lithuania would have to use the indirect methods of determining what the "normal value" in the country of origin is. We should recall that the determination of "normal value" must be convincing to the WTO members, not just to Lithuanians. Such a determination is very demanding and would strain the analytical resources that Lithuania has at its disposal. *Third*, Lithuania would have to rely very much on its customs service to supply data on import transactions. It is not a secret that the customs service is not able to record very accurately all the import transactions of Lithuania, and indeed, the customs service would admit that many transactions are missed entirely. Thus, the task of determining "normal value" in a foreign country and doing so in a manner that is convincing to the other WTO members would be accomplished only at very high cost.

2.2 Injury determination

To apply anti-dumping measures, a country bringing a suit must show not only that dumping has occurred, but that the dumping in question "causes ... or threatens material injury ... or materially retards establishment of a domestic industry."

Unfortunately, the WTO rules on determining whether "material injury" occurs are not defined in any way that makes the term operational. As Hoekman and Kostecki (1995:173) point out, the Agreement provides a list of potential indicators of injury,

⁸This procedure particularly penalizes name brands that are sold through extensive marketing organizations where indirect selling costs are high.

such as actual or potential decline in sales, profits, output, employment and many others, but the Agreement does not explain how these should be related to make the link between dumping and injury. Furthermore, the Agreement leaves the question of indicators open-ended. A country bringing an anti-dumping suit may show material injury in any way that it likes. However injury is defined, it must be demonstrated that it is the dumping that causes the injury. It is not sufficient to show that an industry is simply suffering injury.

Many of the indicators suggested by the WTO that might be used to link dumping with injury are the same indicators that one would use to show that an economic activity is non-competitive. Activities that are simply non-competitive should adjust to make themselves competitive or cease to exist, yet those same activities can use information on their own uncompetitiveness to make a claim for protection under anti-dumping laws. Such claims should have no merit but often find sympathetic listeners among those who are susceptible to domestic political or lobbying interests. Currently, Lithuania has many activities that are not competitive in international markets. Many are still adjusting to structural forces and, unfortunately, many are successful at lobbying for special privileges rather than seeking true structural adjustment.

WTO rules require that injury cannot be implied by dumping that is so small as to be insignificant. A so-called *de minimus* rule applies: if the volume of dumped exports is less than 3% of total imports, then no material injury can be implied.⁹ If the margin of dumping is less than 2%, no dumping damage is assumed. However, in proving material injury, alleged dumping from several sources can be aggregated. If the total exports dumped exceed the *de minimus* amounts, material injury may have occurred. In aggregating dumped exports from several sources, exports from small countries like Lithuania have the possibility of being aggregated with exports of larger countries, even though the exports from the small country would normally have fallen well below the *de minimus* amount. Again, the procedure contains a bias. If it is alleged that several countries are “dumping” the same item, one must begin to question what the normal value of that item is. The fact that the item in question comes from several sources is an indication that the export price is the normal value.

Demonstrating that injury has occurred or that injury is threatened by dumping is a very skill intensive task. Furthermore, the WTO procedure for proving dumping, finding a dumping margin and assessing injury is very demanding. Minor deviations from the procedure will invalidate an anti-dumping claim. Anti-dumping cases are normally conducted by lawyers experienced in these matters. Again, when the dumping case is made, it must be convincing to other WTO members. The skills that Lithuania can bring to bear on this determination are limited and may find better employment elsewhere. This is especially the case where one can easily find activities that are

⁹ The quantity limit on *de minimus* dumping is so small that one would have to question whether such small sales, even if sold at dumped prices could inflict injury. For example, if one-half of sales in the domestic market are occupied by imports, then the item in question would amount to only 1.5% of total sales.

suffering deteriorated business conditions for reasons that are far more powerful than dumping. To show that dumping independently is causing injury within activities that are undergoing structural change is a very difficult task.

Section 3: Kinds of dumping and policy responses

Creating an appropriate policy response to dumping requires some understanding of what motivates the dumping firm and what economic damage threatens the local economy as a result. Even if WTO dumping has occurred, it is not clear that economic dumping has also occurred. Furthermore, the damage we want to identify is economic damage. Since WTO dumping is defined without reference to economic damage, and there is a bias toward finding WTO dumping where economic dumping does not exist, the question of economic damage becomes important. In addition, policy should be focused on a problem or an opportunity. Understanding what motivates dumping (of whatever kind) and its economic impact is necessary for determining a reasonable policy response. In this section we review the main kinds of dumping behavior. In each case, we ask ourselves what economic damage is likely to occur in the local economy if this kind of dumping persists.

3.1 Predatory dumping

This is the classic case and was the primary concern of Viner (1923). Indeed, this is the only category of dumping that from an economic perspective is unambiguously damaging to the importing country. Predatory dumping occurs when a dominant supplier prices its product below cost, with the objective of eliminating competition in the market where dumping occurs. If the exporting firm is successful in destroying the competition, it will be in a monopoly position and be able to more than recoup its losses by charging monopoly prices thereafter. For this kind of dumping to be successful, several conditions must be met:

- The exporter must have sufficient financial resources to be able to suffer losses during the time it takes to drive potential competitors from the market, without destroying itself.
- Once the dumping exporter has eliminated the competition, there must be barriers to the entry of new firms. If there are no such barriers, new firms will re-enter the market to take advantage of the monopoly prices being set by the dumping exporter, thereby destroying the monopoly position of the dumping exporter.
- The dumping exporter must convince the government to prevent other international competitors from entering the market; otherwise its monopoly position will be destroyed.

These conditions make predatory dumping very unlikely. There are very few activities where barriers to entry are great enough to ensure a monopoly position for dumping exporters. It is very unlikely that any government would reward a dumping exporter with protection from the entry of other international suppliers. Predatory dumping could occur where there is one dominant world supplier of the item in question, and where

any other firms producing competing items are very small. In this case, however, the dominant firm would probably find it cheaper to enter an alliance with the smaller firms or to buy them outright, rather than incur the losses that dumping implies (Grumwade, 1996). Predatory dumping is so unlikely to occur that in the post-war period no cases of predatory dumping have been documented (Hoekman and Kostecki, 1995).

The proper policy response to predatory dumping is to ensure competitive markets with few barriers to entry. With open markets the question of predatory dumping is not even likely to occur. In most countries, including Lithuania, monopolistic behavior is illegal, and the efficient policy response to prevent predatory dumping from occurring is to ensure that Lithuania's laws against monopolistic behavior and laws protecting market access are strictly enforced.

3.2 Price discrimination

Price discrimination can occur where producers in an exporting nation sell their output in their home market at the highest price possible, and then sell whatever output remains at world prices in export markets. For price discrimination to occur, two conditions must be met. *First*, in the home market, producers must face a demand for their product that is much less responsive to price than is the case of demand in international markets. In economic terms, the home market must exhibit low price elasticity, while under the small country assumption international demand is perfectly elastic. *Second*, producers in the exporting country must be able to separate the home market from foreign markets so that their attempt to charge higher prices at home is not thwarted by imports at world prices. Measures that may permit them to segment markets in this way include restrictive licensing granting them quasi-monopoly power in the domestic market, laws governing sanitary or technical standards that are applied more restrictively to foreign suppliers, or any barriers to imports. Often we find the apparent paradox of a country levying an import duty on an item that that country generally exports. Such an import duty allows domestic producers to separate foreign from domestic markets, charging the duty-burdened, higher price in the domestic market, while exporting at the world price.¹⁰

Price discrimination is not likely to be harmful to the importing country. Consumers in the exporting country, however, are harmed by the higher price that they face. But in the importing country, consumers face the same price that they would face in the event that no price discrimination were occurring. Producers in the importing country face competition at the world price, but that fact is unaffected by the practice of price discrimination elsewhere.

¹⁰ For example, in Lithuania there is a conventional import tariff of 45% on butter (HS 0405 "butter and other fats and oils derived from milk"), yet Lithuania is an exporter of butter. In 1995 Lithuania exported 20,000 tons of butter worth almost \$36 million. There were insignificant imports of butter worth only about \$90,000, most of which came from Russia. Thus, conditions have been created for price discrimination in Lithuania. This would be viewed as dumping if Lithuanian butter prices were higher than prices at which Lithuania exports butter. In fact in Lithuania, the import duty on butter is applied unevenly. Some tariff quotas allow some butter to enter the country duty-free. However, as long as the duty is applied "at the margin," the price of butter in the country will be determined by the tariff-burdened price.

The WTO anti-dumping rules would allow importing countries to bring a case against exporting countries that allowed price discrimination to occur, even though the importing country suffers no damage. All that is required is for the importing country to show that the “normal price” in the home market exceeds the export price. But the “normal price” in the exporting country is affected by the ability of producers to segment the market and practice price discrimination against the interests of consumers in their own market.¹¹ If criteria for economic dumping were applied, one would find that no economic dumping has occurred. Export sales are not occurring at prices that are below cost. The appropriate economic response from the importing country’s point of view in this case is to do nothing. No injury has been experienced, and no action is called for.

3.3 Excess capacity and cyclical markets

It is common and normal business practice to sell at prices that are below average costs during periods of unforeseen slack demand. During these periods there is excess capacity. As long as price exceeds variable costs, some contribution is made to fixed costs and production should continue. Some industries or activities are more prone to experiencing excess capacity than others. Three cases come to mind. *First*, some activities require that capital be invested in specialized equipment that lasts for a long time. For example, in some places steel manufacturing equipment is still in use that may be fifty or more years old. The equipment can be used for nothing else. When such long-term investments are made, swings in the business cycle cannot be foreseen and periods of excess capacity will surely occur. *Second*, some equipment is designed for continuous use. Technologies for producing glass, some metals, electric power and many chemicals are of this type. Shutting down the equipment during period of slack demand imposes high costs, and may even destroy equipment. The variable cost of continuing production may be less than the variable cost of temporarily stopping production. It is possible that a producer in these activities facing slack demand may choose to continue producing even if the price of the production falls below the variable cost of continuing production. *Third*, laws, regulations and even tradition can make the cost of stopping production greater than the cost of continuing. For example, in Japan, where lifetime employment is the norm, labor costs become a fixed cost. Labor costs do not cease when production stops. In some countries, laying off workers would trigger large severance payments or mandatory retirement benefits. In these cases, the variable costs of stopping may exceed the variable costs of continuing production.

Under the circumstances described, during a slowdown in the business cycle firms may try to satisfy as much domestic demand as they can, then sell their excess in the export market at lower prices.¹² Some circumstances may lead them to sell at prices below

¹¹ It would not be surprising to find some WTO member country bringing an anti-dumping suit against Lithuania for butter exports, for the conditions described in the preceding footnote.

¹² On this point alone the circumstances are similar to the case of price discrimination. Without some ability to segment markets, prices would be the same in export and domestic markets. However, some goods are “naturally protected” in their home market by high

the variable cost of continuing production. This behavior would constitute dumping by the WTO definition and in some cases by the more restrictive economic definition as well. However, while the dumping is unambiguous under the WTO definition, economic dumping would occur only where sales were occurring below the variable costs of continuing versus the variable costs of stopping production. Economic dumping would occur where continuing to produce increases total losses for the enterprise.

Is the home economy in the importing country damaged by this form of dumping? Consumers clearly benefit from buying the item in question at low prices. Import competing producers may not be damaged if the importing and exporting countries are at opposite points in the business cycle. That is, if at the time of excess capacity in the exporting country, there is short capacity in the importing country, no damage is done. This circumstance is unlikely. More likely is that the business cycle is at the same point in both countries. This coincidence of the business cycle between Lithuania and the EU will probably become greater as integration with the EU progresses. If costs in the industry in the importing country are less flexible than they are in the exporting country, then some damage may be done. For example, if labor costs are rigidly determined in the importing country, then the dumped imports would cause unemployment. If labor costs were flexible then the dumped imports may not affect employment levels, but wages would fall. The policy response of the importing country must weigh the losses in employment or lower wages against the benefits to consumers of lower prices.¹³

Where the conditions of an activity are similar to those described, temporary excess capacity, occasional below-cost prices and WTO dumping may be common. Since the basic problem is the business cycle, any policy response should be very short-run, corresponding only to the length of the cycle. When an importing country chronically faces such conditions and its associated problems, the problem may be one of structural adjustment rather than one of simple WTO dumping. If that is the case, then appealing to WTO safeguards and escape clauses may be an appropriate policy response rather than appealing to anti-dumping measures. However, one should realize that safeguards are not intended to provide permanent protection. If application of safeguards is to occur for over one year, "...it shall be progressively liberalized at regular intervals..." (Article 7, Paragraph 5). "A member shall apply safeguard measures to facilitate adjustment" (Article 5) (as quoted by Hidley, 1994).

3.4 Strategic dumping

shipping costs, consumer preference for familiar home-produced brand names, or by long term contracts and inter-firm business practices.

¹³Note, too, that the main problem occurs when both countries are at the same point in the business cycle. When this is the case, the task of finding "material injury" becomes much easier in the country bringing the anti-dumping suit. In an economic downturn all firms suffer difficulties and one would have great difficulties separating injury due to WTO dumping from injury due to other conditions.

Dumping may be part of a firm's strategy to pursue normal business interests. Two main kinds of strategic dumping come to mind. *First*, firms may sell below cost to increase market share and/or to enter a market for the first time. Losses incurred are like an investment in marketing. The objective is to gain market position and not to eliminate competition. Furthermore, selling at below cost to gain market share is a rather short-term strategy. Most firms facing prolonged losses to gain market share (without acquiring a monopoly position in the process) would choose to bypass the opportunity. Damage from this dumping is very little and there may be net benefits. In the long run, domestic import-competing firms face increased competition which will keep pressure on their efficiency. Consumers benefit from lower prices and probably from increased choice. *Second*, some industries face decreasing costs over a significant portion of their cost function. For example, the computer chip industry is well known to have extremely high initial investment costs with rapidly declining average and variable costs as volume increases. In the initial stages of such an investment project, a producer may want to expand production rapidly to take advantage of his economies of scale. By pricing to cover long-run average costs, early sales may occur at less than variable cost for that level of production. WTO dumping will be observed. However, in this case the consumer is the prime beneficiary of low costs.

3.5 Sporadic dumping

Sporadic dumping occurs with no deliberate intention on the part of the producer to export at prices that are below cost. However, circumstances may conspire against him. If a producer is entering a new market that is unfamiliar to him, and particularly if he is selling a new product, pricing is difficult.¹⁴ Many pricing and production errors are likely to occur which could easily appear to be WTO dumping. Damage to importing countries is likely to be small because it is not the intention of the exporter to dump, and indeed it is his intention to sell above cost. Since full-cost pricing is the ultimate objective of the producer, sporadic dumping is likely to be temporary.¹⁵

3.6 Exchange rate-induced dumping

Exchange rate dumping is dumping only in appearance. It can occur when an export transaction occurs between two countries, one or both of which has experienced an abrupt change in exchange rates. Failure to fully adjust for an exchange rate change can happen because of a simple failure to adjust correctly, or because of contracts struck in some benchmark currency with no built-in exchange rate adjustment mechanism. Clearly, exchange rate dumping is not intentional on the part of the

¹⁴Lithuanian exporters should be aware that accusations of dumping may come from other WTO members for these reasons. Many Lithuanian exporters will be active in markets where they have little experience and many will be exporting items in which they have limited production and pricing experience.

¹⁵Anti-dumping cases may take more than a year to prosecute. It is likely that sporadic or exchange rate-related dumping would have ended before a case could be completed.

exporter and is only caused by the confusion associated with unstable exchange rates. The appearance of dumping due to exchange rate variability is most likely to be found in transactions occurring between Lithuania and its eastern neighbors, all of whom experience considerable exchange rate instability. It is hoped that problems of this kind are temporary.

Section 4: Summary

Few kinds of dumping are damaging to the importing country, and even where dumping is damaging, anti-dumping measures may not be the most useful tool with which to seek remedy. In summary, for each kind of dumping the following applies:

<u>Predatory dumping</u>	The one kind of dumping that, if successful, is unambiguously damaging to the importing economy. The most appropriate remedy is effective laws guaranteeing competitive markets.
<u>Price discrimination</u>	No damage to the importing economy. No anti-dumping action is called for.
<u>Excess capacity</u>	Normal business behavior. This is of benefit to consumers and may be damaging to producers. The situation is temporary but could be of long duration. WTO safeguards should be considered as a means of temporarily protecting the injured activity while it adjusts to world markets.
<u>Strategic</u>	Normal business behavior benefiting consumers. May improve competitive environment. Exporter's objective is not monopoly position. No anti-dumping action is called for.
<u>Sporadic and exchange rate</u>	Short term and unintentional dumping. No anti-dumping action is called for.

Section 5: Conclusions

Some of the observations that have been made about dumping and WTO procedures are:

- Dumping as defined by the WTO does not take into account the impact of anti-dumping measures on consumers. Only the characteristics of producers are considered.
- Dumping as defined by the WTO is often unrelated to whether economic damage is implied for the importing country. Dumping is a legal issue for the WTO, not an economic issue, and it is considered by economists to be one of the most objectionable loopholes in the WTO Agreement.
- Most kinds of dumping do not imply economic injury for the importing economy. Only predatory dumping and dumping related to excess capacity are of great concern.
- Predatory dumping is extremely rare. It should be dealt with by strengthening competition protection laws and their enforcement.

- Dumping related to excess capacity may injure producers in the importing country, but consumers may gain. If producers suffer from serious, long-term injury due to the opening of trade, the WTO escape clause would be a more appropriate and objective remedy rather than an anti-dumping measure. In any event an anti-dumping duty can only be as large as the dumping margin.

Lithuania's ability to administer an anti-dumping law and the anti-dumping measures that such a law would specify is very limited, and the process would be costly. This ability is limited at this time by:

- poorly performing customs administration;
- a large "hidden economy;"
- limited resources for assessing "injury" and "normal value" in an exporting country. For WTO purposes these are largely legal questions, not economic ones, and lawyers skilled in these areas would be needed;
- poorly developed accounting profession which would be needed to present an anti-dumping case to WTO members;
- the need for structural adjustment that is not related to dumping but which brings pressures for protection. Lithuania would be under pressure from interest groups to provide anti-dumping duties even in cases where dumping is not occurring; and
- an overly stressed and poorly functioning bureaucracy (e.g., tax administration). The system is already overloaded with laws that cannot be enforced.

In addition to the difficulty that Lithuania would have in bringing a meaningful anti-dumping suit before the WTO, Lithuania will probably have difficulty complying with other WTO requirements. As a member of WTO, Lithuania will be required to report on many economic actions that affect trade. In addition, Lithuania will have to bring itself into conformity with TRIMS, TRIPS and other WTO conventions, as well as report on and defend any subsidy programs or other state interventions. Lithuania will also have to defend itself against possible complaints and actions of other WTO members, such as export subsidy complaints. These obligations are likely to strain the available skills and resources to the point where taking action on anti-dumping investigations would be impractical.

Section 6: Recommendations

We recommend that Lithuania not pass anti-dumping legislation at this time. An anti-dumping law would likely be a waste of time and resources. Anti-dumping laws are optional under WTO, and one-half of WTO members do not have anti-dumping laws, so Lithuania would not be unusual. An anti-dumping law would probably be appropriate in the long run, after the country has built up the infrastructure (i.e., customs and analytical ability) and has attended to more important economic tasks (i.e., restructuring). Priority for the next few years should go to honoring the WTO commitments that are required of all members. At this time the resources that would have to be devoted to administering anti-dumping regulations do not seem justified. In the meantime, and in the absence of an anti-dumping law, Lithuania should strengthen

already existing laws that protect competitive markets. Doing so would provide protection against predatory dumping as well as the other favorable factors that such a law would bring. Anti-dumping duties should not be used as a means of protecting inefficient industries. If industry restructuring is inhibited by adoption of WTO rules, WTO safeguards should be used for temporary protection while restructuring is done. Benefits to consumers should be considered whenever trade-related protective measures are contemplated.

Bibliography

- Finger, M. (1994)
“Subsidies and Countervailing Measures and Anti-dumping Agreements,”
Chapter 9 in OECD.
- GATT (1969)
“Text of the General Agreement,” Geneva.
- ____ (1979)
“Agreement on the Implementation of Article VI of the General Agreement on
Tariffs and Trade (The GATT anti-dumping code),” Geneva.
- ____ (1994a)
“Multilateral Trade Negotiations ... Final Act Embodying the Results of the
Uruguay Round of Multilateral Trade Negotiations,” Geneva.
- ____ (1994b)
“Agreement on the Implementation of Article VI of GATT 1994 (The new anti-
dumping code),” In GATT 1994a, Geneva.
- Grumwade, N. (1996)
INTERNATIONAL TRADE POLICY (London: Routledge).
- Hidley, B. (1994)
“Safeguards, VERs and Anti-dumping Action,” Chapter 8 in OECD.
- Hoekman, B.M. (1995)
“Trade Laws and Institutions: Good Practices and the World Trade
Organization,” World Bank Discussion Paper 282 (Washington: The World
Bank).
- Hoekman, B.M. and M. Kostecki (1995)
THE POLITICAL ECONOMY OF THE WORLD TRADING SYSTEM: FROM
GATT TO WTO (Oxford: The Oxford University Press).
- OECD (1994)
THE NEW WORLD TRADING SYSTEM: READINGS (Paris).
- Viner, J. (1923)
DUMPING: A PROBLEM IN INTERNATIONAL TRADE (Chicago: University of
Chicago Press).